DEPARTMENT OF STATE REVENUE
SUPPLEMENTAL LETTER OF FINDINGS NUMBER: 97-0078 RST

Sales/Use Tax — Industrial Exemptions
FOR TAX PERIODS: 1992, 1993, and 1994

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Sales/Use Tax — Industrial Exemptions

Authority: IC 6-2.5-5-3;
45 IAC 2.2-5-9;
Indiana Department of State Revenue v. Cave Stone, Inc. (1983), 457 N.E.2d 520;
General Motors Corporation v. Department of State Revenue, (Ind.Tax 1991) 578 N.E.2d 399

Taxpayer protests the Department's determination that use tax should have been self-assessed and remitted on purchases of certain equipment.

STATEMENT OF FACTS

Taxpayer's principal business activity involves the mining and selling of coal. In its business, Taxpayer works one underground and several surface mines. To facilitate the shipment of coal to customers, Taxpayer operates rail and barge loadout facilities.

Audit discovered that Taxpayer had failed to pay sales tax, or self-assess use tax, on certain items associated with mining operations. Specifically, Audit proposed assessments of use tax on equipment, Taxpayer contends, was "used to blend different grades of coal together so that the final product meets customer specifications." Taxpayer protested these proposed assessments.

At a subsequent administrative hearing, Taxpayer's protest was denied. Taxpayer then timely requested, and the Department granted, a rehearing.

I. Sales/Use Tax — Industrial Exemptions

DISCUSSION

The following narrative is taken from the initial letter of finding in which the Department denied Taxpayer's protest of use tax assessments on equipment used to "blend" coal.

> Taxpayer mines coal from different locations. After the coal is mined, it is taken to a preparation ("wash" or "prep") plant where it is cleaned. The coal is then segregated by grade into stockpiles. Each stockpile has its own compositional makeup – as measured by ash fusion, temperature, hardness, heat content, moisture, sulfur content, BTU content, and size. This compositional makeup does not remain static. Taxpayer manipulates the characteristics of each stockpile by adding coal from other stockpiles.
>
> Taxpayer's customers burn coal. Because of air quality standards tied to BTU and sulfur emission levels, taxpayer's customers require coal that, when burned, meets these specific emission standards. In order to supply the right mix of coal to its customers, taxpayer manipulates the composite characteristics of each stockpile prior to shipment. Taxpayer calls this manipulation "blending".
>
> "Blending", for taxpayer, refers to any activity that results in the combination of different grades of coal. According to taxpayer, blending activities occur throughout its entire production process. Blending occurs when taxpayer combines, after cleaning, coal from one stockpile with coal from another. Blending occurs when taxpayer transfers coal from aboveground stockpiles to underground hoppers. And blending occurs when taxpayer loads coal from different stockpiles into trucks, and barges, and railway cars. As described, "blending" is a continuous, systematic, and integrated part of taxpayer's production process. To engage in these "blending" activities, taxpayer has purchased a variety of equipment and repair parts. Taxpayer paid neither sales nor use tax on these items.

The Department disagreed with Taxpayer's conceptualization of "blending" and characterization of its mining activities. As previously stated:

> The Department…finds taxpayer's transportation of coal to loadout facilities and the subsequent loading of coal onto barges and railway cars, [should be] characterized as a function of shipping, and not production. As such, they are non-exempt post-production activities.
>
> In reaching this conclusion, the Department is guided by language found in 45 IAC 2.2-5-9. Subsection (g) states the general proposition that *"[t]ransportation equipment* used in mining or extraction is taxable unless it is directly used in the mining or extraction process." Example (3) of subsection (g) illustrates a particularly salient non-exempt activity: "*[f]ront-end loaders, cranes, and equipment used to load coal onto trucks, railroad cars, or barges for delivery to customers are taxable.*" Subsection (e)(1) gives examples of *taxable* machinery, tools, and equipment used in mining and extraction operations - including "*equipment used to load extracted and processed minerals from storage stockpiles to railroad cars.*" Additionally, subsection (j) states *shipping and loading of minerals are non-operational activities*; as such, machinery, tools, and equipment used in these activities are subject to tax. (Emphasis added.)

> Taxpayer's conceptualization of blending is overbroad; blending is neither a subset of nor synonymous with loading. The language of 45 IAC 2.2-5-9 describes two mutually exclusive activities. To accept taxpayer's definition - that blending and loading can be concomitant activities - would nullify the language of 45 IAC 2.2-5-9(g) example 3, as well as subsection (e)(1), and subsection (j). As explicit as the language of 2.2-5-9(c)(4) *exempting* equipment used in blending operations, so to[o] is the language authorizing taxation of equipment used in loading and shipping activities.
>
> * * * * * * * * * *
>
> The Department finds the loading and transport of coal from mines and prep plants to loadout facilities, as well as the loading of coal onto rail cars and barges at loadout facilities, are functions associated with shipping - a taxable post-production activity. Consequently, items used in these activities do not qualify for any of the industrial exemptions. Taxpayer's protest is denied.

Taxpayer, in its *Request for Rehearing*, wrote:

> [W]e disagree with the Department's decision to deny [taxpayer's] protest on the taxation of equipment used to blend coal. Under the Department's analysis, there would appear to be no type of blending practiced in the coal industry that would constitute exempt blending. The blending described in our protest is the blending of coal indicative of coal companies. The Department's regulations provide an exemption for the blending of coal. Given that a duly promulgated regulation carries with it the force of law, the Department is in error in its denial of [taxpayer's] argument.

Taxpayer refers to 45 IAC 2.2-5-9(c)(4), which provides in part:

> The following types of equipment constitute essential and integral parts of the integrated production process and are, therefore, exempt. The fact that such equipment may not touch the work-in-process or, by itself, cause a change in the product is not determinative.
>
> > (F) Equipment used to blend different grades of coal together so that the final product meets customer specifications regarding quality and sulfur content.

At rehearing, Taxpayer directed the Department's attention to previously submitted documents listing items used in the blending of coal. These items, generally, can be classified as **(a)** machinery, **(b)** consumables, and **(c)** replacement parts. Specifically, Taxpayer lists oil, fuel (diesel), grease, tires, batteries, filters, headlamps, windows, block heaters, starters, alternators, tugs, barges, "dozers," loaders, bobcats, uniloaders, locomotives, and one CB radio.

Regulation 45 IAC 2.2-5-9 discusses the taxability of manufacturing machinery, tools, and equipment directly used in extraction and mining operations. Subsection (c)(4) exempts "[e]quipment used to blend different grades of coal…" Subsection (g) states '[t]ransportation equipment used in mining or extraction is taxable unless it is directly used in the mining or extraction process." Subsection (g)(3) exempts transportation equipment used to "transport

work-in-process or semi-finished materials within the extraction or mining process…" Subsections (e)(1), (j), and (g)(Ex.3) instruct that equipment used in shipping and loading activities are taxable.

When 45 IAC 2.2-5-9 is read in its entirety, one realizes the taxing scheme is based on the assumption that "blending," "transport," and "shipping" are separate, mutually exclusive, activities. The Department, therefore, will neither endorse nor adopt a definition of "blending" inconsistent with this regulatory regime. Consequently, the Department must reaffirm the conclusions reached in its initial letter of findings.

FINDING

Taxpayer's protest is denied

PE/BK/MR—001407